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IN THE MATTER OF THE GENERIC
PROCEEDING CONCERNING ELECTRIC
RESTRUCTURING ISSUES

) DOCKET NO. E-00000A-02-0051

IN THE MATTER OF ARIZONA PUBLIC
SERVICE COMPANY'S REQUEST FOR
VARIANCE OF CERTAIN REQUIREMENTS
OF A.A.C. R14-2-1606

) DOCKET NO. E-01345A-01-0822

IN THE MATTER OF THE GENERIC
PROCEEDING CONCERNING THE ARIZONA
INDEPENDENT SCHEDULING
ADMINISTRATOR

) DOCKET NO. E-00000A-01-0630

IN THE MATTER OF TUCSON ELECTRIC
POWER COMPANY'S APPLICATION FOR A
VARIANCE OF CERTAIN ELECTRIC
COMPETITION RULES COMPLIANCE
DATES

) DOCKET NO. E-01933A-02-0069

IN THE MATTER OF THE APPLICATION OF
TUCSON ELECTRIC POWER COMPANY FOR
APPROVAL OF ITS STRANDED COST
RECOVERY

) DOCKET NO. E-01933A-98-0471

RELIANT RESOURCES, INC.'S POST HEARING BRIEF

In compliance with the instructions of Administrative Law Judge Lynn
Farmer ("ALJ Farmer" or the "ALJ"), Reliant Resources, Inc. ("Reliant") files its post

LAW OFFICES

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1 hearing brief setting forth Reliant's position on the four issues addressed in this
2 proceeding: Transfer of Assets; Market Power; Codes of Conduct and Jurisdiction.

3
4 **I. BACKGROUND AND PROCEDURAL HISTORY**

5 The Arizona Corporation Commission (the "Commission") adopted Retail
6 Competition Rules effective on or about December 26, 1996. The Rules provided the
7 framework for Arizona to transition from traditional regulated monopoly to a
8 competitive electric industry. Subsequently, the Rules were amended and re-adopted
9 in whole or in part and the implementation of many of the provisions of the Rules
10 have been delayed, by amendment, settlement or variance. Under the Rules, as
11 amended by individual settlements, both Tucson Electric Power Company ("TEP")
12 and Arizona Public Service Corporation ("APS") are required to divest their
13 competitive generation assets no later than January 1, 2003. See, A.A.C. R14-2-
14 1615.A. APS and TEP had the option of divesting to an affiliated entity or to third
15 parties. Both APS and TEP have elected to divest to an affiliated entity.
16 Additionally, A.A.C. R14-2-1606(B) and the Settlements require all power purchased
17 after January 1, 2003 by APS and TEP for Standard Offer Service must be acquired
18 from the competitive market through prudent, arm's length transactions, with at least
19 50% acquired through a competitive bid process.
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24 On October 18, 2001, APS filed a Request for a Partial Variance to A.A.C.
25 R14-2-1606(B) and for Approval of a Purchase Power Agreement. This Request
26 sought Commission authorization for APS to enter into a long-term (13 years), with

1 three five year options) purchase power agreement with its affiliate, Pinnacle West
2 Energy Corporation ("PinWest"). TEP also filed a request for a variance from a
3 portion of the Competition Rules. The Commission held a Special Open Meeting on
4 April 25, 2002, to consider an Order to Show Cause filed by Panda Gila River, LP
5 requesting the Commission order APS to proceed with implementing the requirements
6 of Rule 1606(B), as well as to consider other issues raised by the Commissioners and
7 Commission Staff regarding the propriety of staying APS' Variance Request until
8 certain other threshold issues were decided. During the Commission's Special Open
9 Meeting, the Commissioners stayed APS' variance hearing, which was scheduled to
10 begin on April 29, 2002, and ordered the Hearing Division to issue a Procedural Order
11 to address certain threshold issues on an expedited basis. Proceedings on TEP's
12 variance request were also stayed by a May 2, 2002 Procedural Order.
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16 On April 29, 2002, a procedural conference was held in this generic docket to
17 discuss how to proceed with the issues identified by the Commissioners at the Special
18 Open Meeting. A Procedural Order was issued May 2, 2002 dividing the proceeding
19 into Track A to consider the issues related to the transfer of assets and associated
20 market power issues, issues regarding the Code of Conduct, the Affiliated Interest
21 Rules, and the jurisdictional issues and Track B to consider issues associated with the
22 competitive solicitation process needed to implement Rule 1606(B). A procedural
23 schedule was developed to address the Track A issues that include the filing of direct
24 testimony on May 29, 2002, the filing of rebuttal testimony on June 11, 2002 and a
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1 public hearing from June 17-21, 2002, and June 27-28, 2002. A Recommended Order
2 is expected on Track A issues on July 22, 2002, with exceptions thereto due July 31,
3 2002. Reliant is a party to these proceedings and filed the direct testimony of Curtis
4 Kebler on May 29, 2002 (Reliant-1).
5

6 **II. MARKET POWER AND RELIANT'S MARKET-BASED SOLUTION**

7 All parties, with the exception of APS and possibly the Arizona Utility
8 Investors Association, recognize that the transfer of all UDC generation assets to an
9 affiliate will result in a concentration of market resources that provide the opportunity
10 for the affiliate to exert market power on the wholesale generation market. *See, e.g.,*
11 Neil Talbot, Direct Testimony (S-6) at 14:12-13; David Schlissel, Direct Testimony
12 (S-8) at 2:15-17; Dr. Richard Rose, Rebuttal Testimony (RUCO-2) at 2: 8-13; Curtis
13 Kebler, Direct Testimony (Reliant-1) at 2:14-15; Dr. Craig Roach, Direct Testimony
14 (Panda-1) at 3:21-23; Thomas Broderick, Rebuttal Testimony (HGC-1) at 7: 4-7; and
15 Kevin Higgins, Direct Testimony (AECC-2) at 14:3-5.
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18 As recognized by Staff witness, Neil H. Talbot:
19

20 [T]he Arizona market is significantly *less* competitive than
21 the regional market. Firstly, it is vulnerable to recurrences of
22 regional problems that could result in regional shortages or
23 price spikes. More importantly, however, the Arizona
24 market is limited by transmission constraints that protect
25 local generators against outside competitors. It is therefore
26 less competitive, at least during some seasons and times of
day."

1 There are two sets of local issues that are critical in
2 restructuring. One is the adequacy or inadequacy of local
3 transmission and generation capacity to diminish *horizontal*
4 market power in the Arizona market. The other is the
5 problem of *vertical* market power resulting from the
6 ownership of transmission and generation facilities by
affiliates of the Utility Distribution Companies (UDCs). The
Commission has considerable authority over these two sets
of issues.

7 Direct Testimony of N. Talbot (S-6) at 12:9-21.

8 While the parties come to different conclusions on the character and existence
9 of market power, there is little doubt that the transfer of assets results in a
10 concentration of generation within a single competitive entity in Arizona. This is
11 particularly true in the State's load pockets where a large portion of load is served (Tr.
12 (Vol. I) at 76-77:19-25,1; Tr. (Vol. I) at 77:14-17). Whether or not the Commission
13 determines this is "market power" in a legal sense, it is obvious that without some
14 form of mitigation or boundary in the short-term, the incumbent utilities will be able
15 to significantly influence the price of electricity in any competitive procurement (Tr.
16 (Vol. III) at 723:12-22).

17 In order to address concerns regarding the transfer of utility assets to an
18 affiliate generating company and the associated market power issues, Reliant witness
19 Curtis Kebler offered a two-pronged market-based proposal. Specifically, the
20 proposal alleviates short-term concerns regarding a utility affiliate holding a highly
21 concentrated amount of generation assets. Reliant's approach also addresses concerns
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1 over existing transmission constraints that limit the amount of external generation that
2 can be imported into certain Arizona load pockets.

3 The first step involves a capacity auction in which wholesale market
4 participants are able to acquire a specified portion of the output of the capacity
5 transferred by the UDC to an affiliate. The asset itself is not sold in this type of
6 auction, only an entitlement to a portion of the output for a period of time. Once the
7 entitlement to a portion of the existing generation capacity has been diversified among
8 multiple market participants, these participants can then compete in the process
9 envisioned under Rule 1606(B) to provide generation services to APS and its
10 Standard Offer customers.
11

12 Rule 1606(B) requires the utilities acquire at least 50% of its Standard Offer
13 power supplies through a competitive bid process. The second step in Reliant's
14 proposal recommends the competitive solicitation process be structured as "slice of
15 system" auctions. Bidders would be competing on the basis of price to provide a
16 specific percentage of APS' daily load requirement. Under this auction procedure,
17 APS would be purchasing a fixed priced product. The contract lengths would vary
18 under this proposal. In addition, Reliant recommends that the power contracts
19 acquired under the competitive solicitation process and arm's length bilateral
20 transactions have staggered delivery dates and varying contract lengths be staggered
21 to increase competition and encourage participation by new or expanding suppliers.
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1 As described by Reliant witness Kebler, this proposal is significant because it
2 demonstrates a potential market-based solution to the concerns raised in Track A (Tr.
3 (Vol. III) at 846:13-22). While details of the Reliant proposal are appropriate to
4 discuss in "Track B" of this proceeding, the proposal is also relevant to Track A. The
5 Commission must recognize that on the one hand decisions made in Track A will
6 directly influence the direction of Track B and, on the other hand, the competitive
7 procurement process(es) established in Track B can, and should be used to address
8 and alleviate concerns raised in Track A. In fact, Reliant's proposal affords the
9 Commission an alternative that addresses the issues arising from the concentration of
10 generation in one or more UDC affiliates, yet avoids unnecessary delay in the
11 implementation of competition for Arizona's Standard Offer load. As a result,
12 consumers will receive the benefits of competition in a timely manner. The capacity
13 auction allows a greater diversity of suppliers to participate in the market for Standard
14 Offer load. As new generation is built and new transmission relieves delivery
15 constraints, the need for a capacity auction will diminish.

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19 In contrast, permitting the incumbent utilities to divest their generation assets
20 to affiliates without the appropriate competitive solicitation procedures in place and
21 underway, as required by Rule 1606(B), will severely jeopardize the long-term
22 viability of competition among wholesale suppliers in Arizona. Such a decision
23 would effectively deny or unreasonably delay Arizona's consumers the benefits
24 provided by vigorous competition.
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1 **III. RELIANT RESOURCES, INC.'S POSITION ON THE OTHER**
2 **SUBSTANTIVE ISSUES IN TRACK A**

3 **A. Reliant Supports Proceeding With Wholesale Competition Sooner**
4 **Rather Than Later.**

5 Like nearly all of the parties in this proceeding, Reliant supports a robust and
6 competitive wholesale market for electricity in Arizona. Like the Commission,
7 Reliant also supports getting competition right and creating a success story. Reliant
8 believes the current competition Rules provide the appropriate framework for a
9 successful transition to competition. Reliant has provided the Commission with a
10 market-based solution to many of the concerns brought forth by the Commission,
11 Staff, and several intervenors that can be implemented without amending any of the
12 Rules¹. This constructive framework should be used as the basis for resolution to the
13 utilities' desire to divest their generating assets, the Commission's desire to provide
14 stable and efficient electricity prices, and the wholesale electricity suppliers' desire
15 for the opportunity to provide Standard Offer load service to the State's UDCs at
16 competitive prices.
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20 **B. Reliant Supports The Transfer Of Assets, Provided A Transparent**
21 **Competitive Solicitation Process Is In Place And Underway.**

22 Throughout this proceeding Reliant has supported the transfer of incumbent
23 utility generation assets to its affiliate. Reliant believes this is the appropriate
24

25 ¹ Reliant believes extensions of compliance deadlines, if any are required, and placement of
26 conditions on the transfer of assets (e.g., requiring a capacity auction) can be accomplished
 through Orders involving specific utilities, after notice and opportunity to be heard.

1 approach to facilitate a vibrant competitive wholesale market in Arizona. However, it
2 is of the utmost importance that the Commission permit divestiture to proceed only in
3 conjunction with competitive procurement for the Standard Offer load as required in
4 1606(B).
5

6 The majority of the parties to this proceeding also agree that divestiture is
7 appropriate, and further believe the competitive procurement required by Rule
8 1606(B) is a necessary and fundamental condition precedent to any divestiture. Any
9 approach that permits divestiture without implementing competitive procurement at
10 the wholesale level, on a fair and transparent basis as envisioned by Rule 1606(B),
11 places at risk the long-term viability of the existing and new generation projects
12 constructed to serve the region's electrical demand. Without these projects, the State's
13 retail consumers cannot be offered the significant benefits associated with a healthy
14 competitive wholesale market.
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17 APS contends divestiture must proceed because divestiture is part of a
18 settlement agreement approved by the Commission (APS-1 at 5:11-23). Yet,
19 through its proposed PPA, APS seeks to alter the fundamental conditions on which
20 the transfer was based—competition under Rule 1606(B). In fact, APS seeks to
21 extend the protection of regulation to assets build by its affiliates (e.g., Redhawk and
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1 West Phoenix), while maintaining the option of using the same assets to compete on
2 the market. This must not be allowed.²

3 By requesting a variance to this rule, APS effectively stagnates the wholesale
4 market in Arizona. This is in stark contrast to their claim that the divestiture and
5 long-term PPA will enhance competition within Arizona (APS-4 at 18-19:19-23,1-4).
6 In fact, APS/PinWest witness Davis readily admits that the PPA results in an
7 additional 13 years of cost-of-service rates without any competitive market test (Tr.
8 (Vol. I) at 95:17-23). Considering the contract renewals of the PPA, the actual length
9 of continued cost-of-service may be closer to 28 years. Staff witness Schlissel
10 rightfully points out that the PPA is a "cost-plus proposal" (Tr. (Vol. VI) at 1400:10-
11 11). This realization further displays that the benefits of competition will not be
12 available to Arizona's ratepayers as the APS Variance is currently proposed.
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16 Panda witness Roach explained that a continuation of cost-of-service rates
17 presents measurable risks to the ratepayers that are reduced with the introduction of
18 competition for Standard Offer load (Panda-3 at 8:11-12; Tr. (Vol. III) at 753:21-25).
19 Reliant wholeheartedly agrees with Dr. Roach's assertion. Furthermore, approving
20 such a variance would be inappropriate for the Arizona ratepayer at this time
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24 ² Neither may Pinnacle West Energy be allowed to transfer these unregulated assets to APS, if
25 divestiture does not take place. These assets were build as competitive assets. Any non-
26 competitive transfer to APS will effectively eliminate the possibility of creating a robust
competitive wholesale market, and the benefits to retail customers associated therewith, for the
foreseeable future.

1 considering the number of parties in this proceeding that have expressed a desire to
2 serve Standard Offer load.

3
4 In light of the concern regarding the transfer of assets, Reliant has presented an
5 approach to competitive solicitation that encourages a vibrant market with many
6 active participants. Furthermore, our proposal provides for an efficient and
7 transparent market price to serve Arizona ratepayers. Varying contract lengths and
8 staggered delivery dates, as proposed by Reliant and others, significantly enhanced
9 the opportunity for vigorous competition to serve Standard Offer customers. The
10 Commission must recognize that these attributes preserve the spirit of 1606(B) and
11 provide stable electricity prices at competitive prices for ratepayers. Notably, the
12 Reliant proposal also allows APS to transfer its generating assets to Pinnacle West.
13
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15 No party in this proceeding argued that Reliant's plan for a capacity auction
16 and load auction is undesirable. Only Harquahala (HGC-1 at 8:1-6) and RUCO
17 (RUCO-2 at 8:17-22) made any mention that they believe the current market
18 protocols do not support these market-based solutions. However, both parties agreed
19 that the proposals have merit and provided support for their use in the future (HGC-1
20 at 7:10-25; RUCO-2 at 8:17-22). Reliant agrees that protocols will need to be
21 established to fully implement our plan. However, Reliant strongly believes that
22 protocols can be established in short order through stakeholder workshops and still
23 allow Arizona's utilities to meet the requirements of 1606(B), sooner rather than later.
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1 Expedition of this process is possible. For example, APS' witness Davis
2 discussed that the company already has the ability to receive or deliver power with
3 third parties (Tr. (Vol. I) at 145:2-11). The protocols currently used for these
4 deliveries can be utilized as a basis for protocols in stakeholder workshops to be held
5 upon the completion of this docket. While this will take intense work on the part of
6 all involved, it is a process that can produce positive results for Arizona's Standard
7 Offer customers.
8

9
10 The inclusion of competitive procurement with any approval of the transfer of
11 assets is paramount to the success of Arizona's competitive wholesale electricity
12 market. As several parties pointed out, the transfer-and-PPA proposal of APS only
13 leads to non-competitive prices for up to 28 years for a large number of Arizona
14 ratepayers. This should not be an acceptable outcome for the Commission when
15 superior market-based proposals are available.
16

17 Several parties presented the Commission with different plans for an
18 appropriate method of the transfer of assets from the incumbent utility to its affiliate.
19 Staff witness Schlissel (S-8 at 2:24-26) and RUCO witness Rosen (RUCO-1 at 47:13-
20 22) both support additional market power analyses prior to divestiture. The record
21 already has at least two market power studies plus additional insightful information
22 from numerous witnesses to these proceedings. Further, market power studies are
23 therefore unnecessary. Indeed, Reliant has proposed a market-based solution that
24 abrogates the need for additional market power studies.
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1 The Track A hearings produced support for a significant portion of Standard
2 Offer load to be competitively procured today (Tr. (Vol. IV) at 978-979:25,1-3).
3 Additionally, Reliant has proposed a balanced market-based alternative to address
4 market power concerns. Yet, Reliant realizes that current time constraints may lead
5 the Commission to conclude that an altered schedule or arrangement is appropriate to
6 achieve the requirements of Rule 1606(B). This might include the staggered transfer
7 of assets from the utility to a generation company affiliate. In turn, the amount of
8 Standard Offer load available for competitive bid could be phased-in incrementally.
9 In the event an additional phase-in period is ordered, the Commission must also
10 provide a clear and firm framework to ensure Arizona continues to move toward
11 competition expeditiously. Otherwise, the Commission risks foreclosing meaningful
12 wholesale competition and the benefits to retail customers that flow therefrom for the
13 foreseeable future. The failure to continue toward wholesale competition will also
14 unduly penalize the merchant generators who have responded to the Commission's
15 invitation to compete in Arizona. These adverse consequences arise because the
16 incumbent utilities have not adequately prepared to implement Rule 1606(B).

21 **C. Affiliate Transactions And The Code Of Conduct Must Be**
22 **Strengthened To Ensure A Level Playing Field.**

23 Staff proposes a process to establish new codes of conducts for transactions
24 between a utility and its energy-services related businesses (Staff-11 at 7:11-26).
25 Staff witness Keene believes that the proposed Code of Conduct fills a void in the
26

1 rules and codes currently in place between a utility and its affiliates (Tr. (Vol. VI) at
2 1445:19-24). Reliant concurs that further consideration of Arizona's Code of
3 Conduct is appropriate to ensure ratepayers do not subsidize any non-regulated
4 competitive operations. The Code of Conduct is an important element for the
5 development of a level-playing field for wholesale competitors in the State.
6

7 While Reliant agrees that several different sets of affiliate transaction rules and
8 codes of conducts from different regulatory bodies are currently in place and apply to
9 Arizona's utilities, Staff's proposal appears to address concerns outside of the current
10 applicable rules. With the alterations in language as found in Staff-12, Reliant
11 believes there is an appropriate starting point for a new Code of Conduct.
12

13 Reliant also believes that the corrections provided in Staff-12 concerning the
14 pricing of transfers or sales between the utility and affiliate brings closure to many of
15 the arguments against an updated Code of Conduct. For example, APS witness
16 Cicchetti had argued against the pricing recommendation that was subsequently
17 removed from the Staff's corrected comments (APS-3 at 26-27:22-24,1-2). With this
18 matter resolved, or at the very least reserved for a more appropriate forum, there is
19 little incentive to argue against Staff's recommendation.
20

21 The development of the new Code of Conduct must not be allowed to cause a
22 material delay in the competitive procurement of Standard Offer load. Such a delay
23 will only cause uncertainty for the market and stall the benefits of competition that
24 would otherwise be available to Arizona's Standard Offer customers.
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26

1 **D. Jurisdictional Issues Should Not Halt Implementation Of**
2 **Competition**

3 The Commission, Staff, and other parties have shown significant concern over
4 the placement of jurisdiction over generation assets in Arizona that are divested from
5 the incumbent utility to an affiliate. In particular, concerns have been raised
6 regarding the status of WestConnect (Tr. (Vol. I) at 237:19-20). The record
7 adequately covers the status of WestConnect and the market monitoring functions of
8 Regional Transmission Organizations (RTO). Furthermore, APS' witness
9 Hieronymus (Tr. (Vol. IV) at 993:6-14), recognizes the likelihood of WestConnect
10 being approved as a for-profit RTO is highly unlikely given FERC's recent decision
11 regarding the Alliance in the Midwest³.
12

13
14 The Commission and Staff's greater concern appears to be the transfer of
15 jurisdiction over the generation assets from the Commission to FERC when
16 divestiture occurs and the ability of FERC to create and monitor appropriate
17 safeguards to minimize risks to retail customers. The testimony of Staff witness, Paul
18 Peterson demonstrates FERC is proactively implementing appropriate safeguards to
19 protect electric consumers at the wholesale level. The Commission should not stifle
20 competition just because the record establishes that the former APS power plants have
21 gained Exempt Wholesale Generator status from FERC (Tr. (Vol. I) at 231:16-22) and
22 the proposed PPA would be a FERC-approved tariff (Tr. (Vol. I) at 232:7-11).
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25

26 ³ 97 FERC para 61,327 (2001).

1 Reliant agrees with the statement of Panda witness Roach regarding the ability
2 of the Commission to take proactive steps to control the mechanisms and inputs of
3 competitive solicitation so that these concerns may be allayed (Tr. (Vol. III) at 726:1-
4 8). In making a decision regarding these issues, the Commission must consider a
5 long-term vision for competition in Arizona. As many of the competitive suppliers in
6 this proceeding attested to, there is great interest in serving Arizona's Standard Offer
7 load. This is a positive signal that competition implemented under the existing rules
8 will produce an efficient and transparent outcome .
9
10

11 IV. CONCLUSION

12 No testimony was presented in this proceeding questioning either the wisdom
13 of moving toward competition or the benefits provided by competition. The
14 Commission must not reverse course now. It is imperative for the long-term success
15 of the wholesale market in Arizona that any transfer of assets from the utility to an
16 affiliate is done in conjunction with a plan for competitive solicitation as required in
17 Rule 1606(B). Reliant Resources has provided a market-based solution to these
18 matters that has been proven to be successful in other jurisdictions. Reliant's proposal
19 for capacity auctions and load auctions adheres to the requirements of 1606(B),
20 allows Arizona's utilities to transfer their generation assets to an affiliate, and
21 addresses the most important concerns explored in this proceeding. Furthermore,
22 Reliant's proposal addresses the parties' very real concern of market power in
23 Arizona with a solution that utilizes the market to mitigate the concentration of assets.
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1 Importantly, the Reliant proposal envisions a transparent and efficient market that will
2 bring the benefits of competition to Arizona's consumers. To ensure that these
3 consumers have access to these benefits, it is important that the Commission take the
4 steps to facilitate this access as envisioned in the Electric Competition Rules.
5

6 RESPECTFULLY submitted this 10th day of July, 2002.

7 MARTINEZ & CURTIS, P.C.
8

9 By 
10

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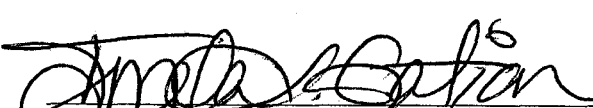
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